REPORT ON EXAMINATION

OF THE

MERCHANTS MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2008

DATE OF REPORT	SEPTEMBER 25, 2009
EXAMINER	ADEBOLA AWOFESO

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

September 25, 2009

Honorable James J Wrynn
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30309 dated March 12, 2009 attached hereto, I have made an examination into the condition and affairs of Merchants Mutual Insurance Company as of December 31, 2008, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Merchants Mutual Insurance Company.

Wherever the designation "National" appears herein without qualification, it should be understood to indicate Merchants National Insurance Company, a newly formed subsidiary of the Company.

Wherever the designation "Preferred" appears herein without qualification, it should be understood to indicate Merchants Preferred Insurance Company, a newly formed subsidiary of National.

Wherever the designation "MNH" appears herein without qualification, it should be understood to indicate Merchants Insurance Company of New Hampshire, the former subsidiary of the Company now known as American European Insurance Company or "AEIC."

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company’s home office located at 250 Main Street, Buffalo, NY 14202.

1. SCOPE OF EXAMINATION

The Department has performed a multi-state examination of Merchants Mutual Insurance Company. The previous examination was conducted as of December 31, 2003. This examination covered the five year period from January 1, 2004 through December 31, 2008. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook, which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company's own control environment. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

Significant subsequent events
Company history
Corporate records
Management and control
Fidelity bonds and other insurance
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Merchants Mutual Insurance Company was incorporated under the laws of the State of New York as the Merchants Mutual Automobile Liability Insurance Company on April 10, 1917 and commenced business on March 5, 1918.

In 1923, the corporate name was changed to Merchants Mutual Casualty Company and the current name was adopted on March 1, 1957.

The Company established two new subsidiaries during 2006, Merchants National Insurance Company ("National"), a New Hampshire domiciled insurer, and Merchants Preferred Insurance Company ("Preferred"), a New York domiciled insurer, which is 100% owned by National.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than thirty six members, divided into three classes as equally as possible. One class is elected at each annual policyholders' meeting for a term of three years. The board met at least four times during each calendar year. At December 31, 2008, the board of directors was comprised of the following thirteen members:

Name and Residence	Principal Business Affiliation
Franklyn S. Barry, Jr. Buffalo, NY	Retired, Former President and Chief Executive Officer, Aethlon Medical, Inc.
Gary M. Brost Buffalo, NY	Chairman and Chief Executive Officer, Strategic Investments & Holdings, Inc.
Randall L. Clark East Amherst, NY	Chairman, Dunn Tire Corporation., LLC

Name and Residence	Principal Business Affiliation
Linda P. Duch Naples, FL	President, Partners for Business
John T. Hoskins Lakeview, NY	Chairman and Chief Executive Officer, Curtis Screw Company, Inc.
Muriel A. Howard Buffalo, NY	President, Buffalo State College
Margaret N. Kafka Cheektowaga, NY	Vice President, Corporate Services, Merchants Insurance Group
Brian J. Lipke Derby, NY	Chairman and Chief Executive Officer, Gibraltar Industries
Bryant H. Prentice Jacksonville, FL	Chairman and Chief Executive Officer, Bryant & Stratton College
Kurt Wiedenhaupt East Aurora, NY	Retired, Former President and Chief Executive Officer, American Precision Industries
Edward Wright Hamburg, NY	President and Chief Executive Officer, W. J. Cox Associates, Inc.
Robert M. Zak Buffalo, NY	President and Chief Executive Officer, Merchants Mutual Insurance Company Merchants Preferred Insurance Company Merchants National Insurance Company
Ronald K. Zoeller Orchard Park, NY	Chief Executive Officer, Azeros Health Care

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

As of December 31, 2008, the principal officers of the Company were as follows:

Name	Title
Robert M. Zak	President and Chief Executive Officer
Fred A. Hildebrand	Senior Vice President, Insurance Operations
Charles E. Makey, III	Vice President, Regional Manager

Name	Title
Edward M. Murphy	Vice President, Investments and Secretary
Kenneth J. Wilson	Vice President, Chief Financial Officer, and Treasurer
Robert H. Fagerburg	Vice President, Claims
Camilla G. Belser	Vice President, Regional Manager
Margaret N. Kafka	Vice President, Corporate Services
Thomas B. Harris	Vice President, Underwriting
Clark M. Sykes	Vice President, Information Technology
Daniel J. Bierbrauer, Jr.	Vice President, Sales and Marketing
Salvatore T. LaDuca, III	Vice President, Finance and Chief Actuary

B. Territory and Plan of Operation

As of December 31, 2008, the Company was licensed to write business in the following fourteen states:

Delaware	New Jersey
Indiana	New York
Maine	Ohio
Maryland	Pennsylvania
Massachusetts	Rhode Island
Michigan	Vermont
New Hampshire	Virginia

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Line of Business
3	Accident & health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
26(a)(b)(c)(d)	Gap
29	Legal services

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $4,000,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination.

DIRECT WRITTEN PREMIUMS ($000 Omitted)

Calendar Year	New York State	Total Premiums	Premiums Written in New York State as a Percentage of Total Premium
2004	$83,983	$137,239	61.19%
2005	$90,771	$141,696	64.06%
2006	$91,422	$150,605	60.70%
2007	$85,039	$144,555	58.83%
2008	$80,955	$138,021	58.65%

The Company is a northeast regional property and casualty insurer. Commercial lines operations are focused on small "main street" businesses with fewer than twenty-five employees and small artisan contractors. Commercial coverages include special multiple peril ("SMP"), business owners' packages ("BOP"), commercial automobile, general liability and workers' compensation. Personal lines coverages focus on middle to upper middle-income individuals who own homes and own/lease automobiles. Business is generated through approximately 650 independent agents. Business centers are maintained in Bedford, NH; Mt. Laurel, NJ; Buffalo, NY; Hauppauge, NY; Albany, NY; and Dublin, OH. The company services its agents from these six business centers and its home office in Buffalo, NY. Personal lines growth plans call for expansion into Ohio, Michigan, Massachusetts and Pennsylvania.

C. <u>Reinsurance</u>

<u>Assumed</u>

Assumed reinsurance accounted for 28% of the Company’s gross premium written at December 31, 2008. During the period covered by this examination, the Company’s assumed reinsurance business has increased since the last examination. The Company’s assumed reinsurance program consists mainly of its participation in the reinsurance pooling agreements noted below. Additionally, the Company's participation in various mandated pools is reflected in its assumed reinsurance activity.

Effective January 1, 2003, the Company and American European Insurance Company (“AEIC,” formerly known as Merchants Insurance Company of New Hampshire, Inc.) entered into a reinsurance pooling agreement (“Original Pooling Agreement”), whereby the two parties agreed that the business operations with respect to certain specified classes of business (referred to as their “Traditional Insurance Business”) should be managed and administered by the Company on behalf of the Company and AEIC. Pursuant to the Original Pooling Agreement, AEIC cedes 100% of its Traditional Insurance Business to the Company and the Company cedes 25% of the pooled business back to AEIC. Effective in March 2007, the Company and AEIC are no longer affiliated; however, the agreement remains in effect as of the date of this report. Additionally, effective in 2006, the Company formed two new subsidiaries; Merchants National Insurance Company (“National”) and Merchants Preferred Insurance Company (“Preferred”). To the extent that any business written by Preferred falls within the definition of Traditional Insurance Business, Preferred has been deemed to be a party to the Original Pooling Agreement and such Traditional Insurance Business is subject to the Original Pooling Agreement. If the Company, Preferred or National writes business that is not Traditional Insurance Business, they may offer to cede such business to AEIC under the Original Pooling Agreement. In such case AEIC has the option, but is not obligated, to accept the business under the Original Pooling Agreement.

Effective January 1, 2007, the Company, entered into a reinsurance pooling agreement with National and Preferred (“Merchants Pooling Agreement”), whereby the three companies agree to share the 75% of the Traditional Insurance Business retained by the Company pursuant to the Original Pooling Agreement. The Company’s, National’s and Preferred’s shares of the subject business are 70%, 20% and 10%, respectively.

The Company utilizes reinsurance accounting as defined in the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles ("SSAP") No. 62 for all of its assumed reinsurance business.

Ceded

The Company structured its ceded reinsurance program on its direct business to limit its maximum exposure through various excess of loss and quota share reinsurance treaties. The Company utilizes facultative reinsurance for policies with limits exceeding a threshold specific to each product line. The Company also purchased catastrophe reinsurance covering property and workers' compensation.

The following is a description of the Company's ceded reinsurance program in effect at December 31, 2008:

Type of treaty	Cession
Property:	
Excess of Loss 2 Layers 100% Authorized	$6,500,000 excess of $500,000 each risk, each occurrence (including terrorism and fire)
Catastrophe Excess of Loss 3 Layers 51%, 45%, and 31% Authorized	$85,000,000 limit, $10,000,000 retention, $10,000,000 excess of $10,000,000 1st layer, $45,000,000 excess of $20,000,000 2nd layer and $20,000,000 excess of $65,000,000 3rd layer. 10% coinsurance contribution on all layers above retention.
Casualty:	
Excess of Loss 3 Layers 100% Authorized	$9,250,000 excess of $750,000 each occurrence.
Workers' Compensation:	
Catastrophe Excess of Loss 1 Layer 100% Authorized	$15,000,000 excess of $10,000,000 each claimant each occurrence. Limited to $30,000,000 all occurrences each calendar year.
Personal Umbrella Liability	
Quota Share 100% Authorized	75% quota share of the first $1,000,000, and 100% of amounts in excess of $1,000,000, not exceeding $5,000,000 each occurrence.

Type of treaty	Cession
Commercial Umbrella Liability Quota Share 100% Authorized	75% quota share of the first $1,000,000 plus 100% of amounts in excess of $1,000,000, not exceeding $5,000,000 each occurrence.
Monoline Commercial Umbrella Liability Quota Share 100% Authorized	90% quota share of the first $1,000,000 each occurrence, and 100% of amounts in excess of $1,000,000 resulting from each occurrence not exceeding $10,000,000.

In addition to its treaty reinsurance program, the Company also obtained automatic facultative reinsurance coverage in addition to its basic coverage for property losses. The facultative treaty will provide coverage of $13,000,000 excess of $7,000,000.

Since the last examination the retention and limit for the casualty excess of loss treaty remained at $750,000 and $9,250,000 respectively. The policy limit for the catastrophe excess of loss increased from $60,000,000 to $85,000,000. The quota share for the personal and commercial umbrella and the monoline commercial umbrella programs remained at 75% and 90%, respectively. The policy limit for the Workers' Compensation program increased from $5,000,000 to $15,000,000 but the retention of $10,000,000 remained the same. The limit of $9,500,000 for the property per risk coverage was reduced to $6,500,000 while the retention of $500,000 remained the same. As of the examination date, the major portions of the Company's reinsurance were with authorized reinsurers.

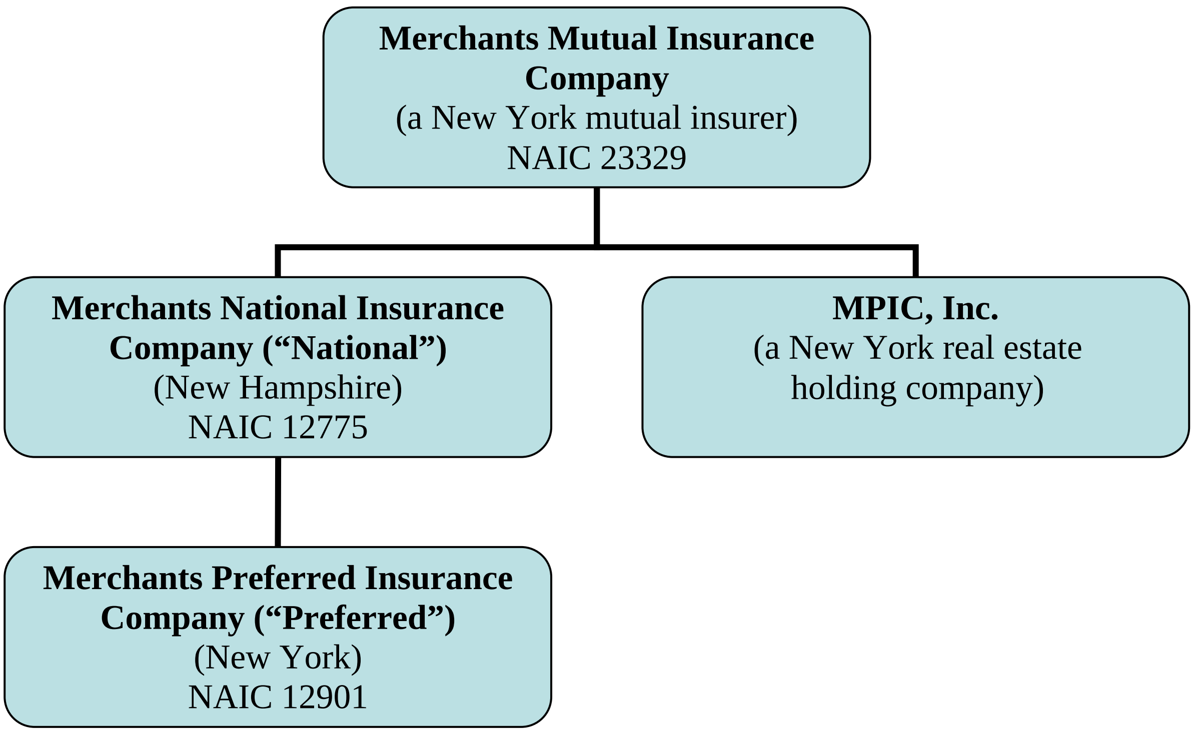
The ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required standard clauses including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to the NAIC annual statement instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

D. Organization Chart

As a mutual insurer, the Company is not subject to the provisions of Article 15 of the New York Insurance Law. However, the Company is required to submit an annual holding company registration statement with this Department pursuant to the provisions of Circular Letter 16 (2009). The Company made the required filings on a timely basis.

The following is an organization chart of the Company and its affiliated entities at December 31, 2008:



Prior to March 2007, the Company owned shares of Merchants Group, Inc. ("MGI"), which in turn owned 100% of the shares of Merchants Insurance Company of New Hampshire, Inc. ("MNH"). Pursuant to an Agreement and Plan of Merger dated March 30, 2007, American European Group, Inc. ("AEG"), a Delaware corporation, acquired 100% ownership and control of MGI. Subsequent to the acquisition, MGI's name was changed to American European Insurance Group, Inc. and MNH's name was changed to American European Insurance Company ("AEIC").

At December 31, 2008, the Company was party to the following agreements with other affiliated entities:

Management Agreement

Effective October 18, 2006, the Company entered into a management agreement with Preferred and National. Pursuant to the terms of the agreement the Company agreed to provide Preferred and National with facilities, management and personnel required to operate their business. This agreement was approved by the Department.

Lease Agreement

Effective October 31, 2002, the Company entered into a leasing agreement with its subsidiary MPIC, Inc. Under the terms of the agreement, MPIC, Inc. leases the main administrative office at 250 Main Street, Buffalo, NY to the Company. The office is owned by MPIC, Inc. The terms of the lease are comparable to other leases in the Buffalo area. This agreement was approved by the Department.

Services Agreement

Effective January 1, 2003, the Company and its affiliates at the time, MGI and MNH, entered into a services agreement, pursuant to which, the Company would provide certain administrative, underwriting, claims and investment services to MNH and its parent MGI, on a fee basis. This agreement was approved by the Department.

Tax Allocation Agreement

Effective January 1, 2007, the Company entered into a tax allocation agreement with its subsidiaries. Pursuant to the terms of the agreement, the parties will file a consolidated federal income tax return. The agreement provides that the Company's tax liability on a consolidated basis will not exceed the liability had it filed its tax return on a stand alone basis. This agreement was filed with the Department.

Department Circular Letter No. 33 (1979) states in part:

> To help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses an escrow account consisting of assets eligible as an investment for the domestic insurer shall be established and maintained by the parent in an amount equal to the excess of the amount paid by the domestic insurer to the parent for federal income taxes over the actual payment made by the parent to the Internal Revenue Service".

Pursuant to Department Circular Letter No. 33 (1979), this provision would help assure the related insurers' enforceable right to recoup federal income taxes in the event of future net losses. During the review of this agreement the Company advised that no escrow account was established as stated therein.

It is recommended that the Company comply with the provision of its approved tax allocation agreement and Department Circular Letter No. 33 (1979), and establish an escrow account to assure the subsidiaries' enforceable right to recoup federal income taxes in the event of future losses.

License and Renewal Rights Agreement

Upon consummation of the Agreement and Plan of Merger agreement referenced previously in this section of this report, and pursuant to an agreement entered into in December 2006 by and among the Company, Preferred, MPIC Inc, MGI, MNH, AEG, Rutgers Casualty Insurance Company and Rutgers Enhanced Insurance Company, MNH sold the renewal rights to all its traditional business to the Company. The agreement is effective for twenty-four months from its effective date August 9, 2007.

The license and renewal agreement allowed:

(a) MNH to grant MPIC Inc. an exclusive license and authorized MPIC Inc. and any of its insurance subsidiaries to use and access policy, insured, agent, and producer data related to in-force policies of MNH.

(b) The Pooling agreement between the Company and MNH/AEIC (the "AEIC Pooling Agreement") to continue through December 31, 2009, during which time the respective shares of pooled premiums, losses and loss and loss adjustment expenses incurred remain at 75% for the Company and 25% for MNH/AEIC.

(c) The underwriting and claims annexes of the services agreement to continue through the term of the AEIC Pooling Agreement.

(d) MGI and MNH to change their corporate and trade names to delete all references to "Merchants" and cease to use the Merchants name. MNH has since changed its name to American European Insurance Company.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2008, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	.72:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	70%
Premiums in course of collection to surplus as regards policyholders	2%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$314,792,756	60.50%
Other underwriting expenses incurred	179,834,418	34.56
Net underwriting gain	25,704,875	4.94
Premiums earned	$520,332,049	100.00%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2008 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$261,921,462	$ 0	$261,921,462
Preferred stocks	2,617,916		2,617,916
Common stocks	33,641,680		33,641,680
Cash, cash equivalents and short-term investments	1,259,223		1,259,223
Other invested assets	544,925		544,925
Investment income due and accrued	1,710,664		1,710,664
Uncollected premiums and agents' balances in the course of collection	2,809,490	367,770	2,441,720
Deferred premiums, agents' balances and installments booked but deferred and not yet due	25,284,330		25,284,330
Amounts recoverable from reinsurers	346,733		346,733
Funds held by or deposited with reinsured companies	2,992,521		2,992,521
Current federal and foreign income tax recoverable and interest thereon	3,623,745		3,623,745
Net deferred tax asset	15,577,000	10,296,000	5,281,000
Electronic data processing equipment and software	2,721,802	1,709,349	1,012,453
Furniture and equipment, including health care delivery assets	478,171	478,171	0
Receivables from parent, subsidiaries and affiliates	108,318		108,318
Prepaid expenses	843,579	843,579	0
Leasehold improvements	5,287	5,287	0
Equities and deposits in pools and associations	1,329,363		1,329,363
Miscellaneous receivable	96,702	96,702	0
Total assets	$357,912,911	$13,796,858	$344,116,053

Liabilities, Surplus and Other Funds

Liabilities		
Losses and Loss adjustment expenses		$154,990,694
Commissions payable, contingent commissions and other similar charges		3,331,474
Other expenses (excluding taxes, licenses and fees)		7,720,029
Taxes, licenses and fees (excluding federal and foreign income taxes)		713,106
Unearned premiums		47,671,925
Advance premium		419,509
Dividends declared and unpaid: Policyholders		126,000
Ceded reinsurance premiums payable (net of ceding commissions)		2,121,647
Funds held by company under reinsurance treaties		153,418
Amounts withheld or retained by company for account of others		576,219
Provision for reinsurance		666,175
Reserve for uncashed checks		467,688
Unearned ceded commission income		77,208
Unearned investment income		278,243
Total liabilities		$219,313,335
Surplus and Other Funds		
Voluntary reserve	$ 1,500,000	
Special contingent reserve	1,500,000	
Surplus notes	32,000,000	
Unassigned funds (surplus)	89,802,718	
Surplus as regards policyholders		124,802,718
Total liabilities, surplus and other funds		$344,116,053

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2006. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2007 through 2008. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $57,975,013 during the five year examination period January 1, 2004 through December 31, 2008, detailed as follows:

Underwriting Income		
Premiums earned		$520,332,049
Deductions:		
Losses incurred	$247,610,856	
Loss adjustment expenses incurred	67,181,900	
Other underwriting expenses incurred	177,823,748	
Aggregate write-ins for underwriting deductions	2,010,670	
Total underwriting deductions		494,627,174
Net underwriting gain		$ 25,704,875
Investment Income		
Net investment income earned	$ 51,496,058	
Net realized capital gain	(3,895,331)	
Net investment gain		47,600,727
Other Income		
Net gain or (loss) from agents' or premium balances charged off	$ (1,228,053)	
Finance and service charges not included in premiums	6,599,315	
Aggregate write-ins for miscellaneous income	(64,025)	
Total other income		$ 5,307,237
Net income before dividends to policyholders and before federal and foreign income taxes		$ 78,612,839
Dividends to policyholders		373,211
Net income after dividends to policyholders but before federal and foreign income taxes		$ 78,239,628
Federal and foreign income taxes incurred		22,622,201
Net income		$ 55,617,427

C. Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2003			$ 66,827,705
Net income	$55,617,427		
Net unrealized capital gains or (losses)		7,762,997	
Change in net deferred income tax	1,715,000		
Change in non-admitted assets		8,283,846	
Change in provision for reinsurance	523,429		
Change in surplus notes	16,000,000		
Cumulative effect of changes in accounting principles	166,000		
Total gains and losses	$74,021,856	$16,046,843	
Net increase (decrease) in surplus			$ 57,975,013
Surplus as regards policyholders per report on examination as of December 31, 2008			$124,802,718

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $154,990,694 is the same as reported by the Company as of December 31, 2008. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company’s internal records and in its filed annual statements.

Upon review of the Actuarial Report (“Report”) underlying the Company’s reported loss and loss adjustment expense reserves, it was found that the Report was not clearly documented and the exhibits underlying the analysis were not easily mapped to the top-level summary exhibits and the Actuary’s conclusions. Therefore, the Report did not meet the NAIC requirement to “provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work.” It is recommended that in the future, the Actuarial Report be improved to meet the NAIC requirements.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at the Company's claims practices. No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained five recommendations as follows (page numbers refer to the prior report):

ITEM		PAGE NO.
A.	Accounts and Records	
i.	Earned But Unbilled Premium It is recommended that the Company comply with SSAP No. 53 and record an estimate for its earned but unbilled premiums in the period that the policy is written. The Company has complied with this recommendation.	12
ii.	Advance Premiums It is recommended that the Company comply with paragraph 13 of SSAP No. 53 and report any advance premiums collected as a liability in its filed annual statement. The Company has complied with this recommendation.	12
iii.	Outstanding Checks It is recommended that the Company comply with SSAP No. 2 and report any outstanding checks as a reduction in cash in its filed annual statements. The Company has complied with this recommendation.	13

ITEM			PAGE NO.
iv.	Notes to the Financial Statement It is recommended that the Company comply with the annual statement instructions when completing the Notes to the Financial Statements in its filed annual statements and report any commutation of ceded reinsurance treaties in the appropriate note. The Company has complied with this recommendation.		14
v.	Regulation 30 It is recommended that the Company undertake a study to ensure that its salaries and other expenses are properly allocated to the expense groups pursuant to the provisions of Part 109 of Department Regulation 30. The Company has complied with this recommendation.		14

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Tax Allocation Agreement	
	It is recommended that the Company comply with the provision of its approved tax allocation agreement and Department Circular Letter No. 33 (1979) and establish an escrow account to assure the subsidiaries' enforceable right to recoup federal income taxes in the event of future losses.	12
B.	Losses and Loss Adjustment Expenses	
	It is recommended that in the future, the Actuarial Report be improved to meet the NAIC requirements.	17

Respectfully submitted,

____
Adebola Awofeso
Senior Insurance Examiner

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

ADEBOLA AWOFESO, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

____
Adebola Awofeso

Subscribed and sworn to before me

this__________ day of ____________________, 2009.

Appointment No. 30309

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, Eric R. Dinallo, *Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Adebola Awofeso

as proper person to examine into the affairs of the

MERCHANTS MUTUAL INSURANCE COMPANY

and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York,

this 12th *day of* March, *2009*

STATE OF NEW YORK
SUPERINTENDENT OF INSURANCE
EXCELSIOR

ERIC R. DINALLO
Superintendent of Insurance